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TRANSCRIPT

The Net-Zero Journey Begins with a Single Step

Featuring:

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Jorge Mina, *Head of Analytics, MSCI*

Adam Bass (00:03):

This is MSCI Perspectives. Your stories for insights for global investors, and access to research and expertise from across the investment industry. I'm your host, Adam Bass, and today is April 21st 2022. Today On the program, last year it felt like every day a different company around the world was announcing a net zero goal. Some, like Netflix, went very big proclaiming that they would achieve net zero greenhouse gas emissions by the end of 2022.

Adam Bass (00:37):

For those of you keeping score at home, that's eight months from now. Others, including the firm I work for, MSCI, were a bit more measured, aiming toward 2040. But regardless of the chosen date, many companies, investors, countries and individuals have realized that the time for talk is done. O n today's episode we're going to try to get as specific and concrete as possible, because in 2022 we all simply need to roll up our sleeves ad get to work.

Diana Tidd (01:12):

I look back with colleagues and we kind of laugh, "Oh, last year we felt like we were on top of all of this." And so much has changed that you see how much more you could be doing, and are doing.

Adam Bass (01:24):

That's today's first guest.

Diana Tidd (01:26):

Hi, I'm Diana Tidd and chief responsibility officer at MSCI. From setting our net zero target, which is setting a goal with a company where you don't have line of sight necessarily into how you're achieving it. So, that itself was a big step. The next step is really looking into that goal and thinking about interim

targets to make sure that we're on the path to achieve that goal, and we had these points where we're stopping and double checking, and making we're on that right path.

Diana Tidd (01:58):

Since we set our net zero target we started looking at our near term target, and we step again and say, "Okay, what's the latest climate science saying?" And what it's saying is that the world need to cut emissions by 50% globally by 2030. So, that helps inform near term target setting for companies. And then we thought about, "Okay, how can we tangibly achieve these targets if we're to update our near term target?"

Diana Tidd (02:27):

And when you look at a sector like finance it's important to try to say, "How can we get line of sight to make us feel comfortable we could actually achieve a goal?" And in this area, because we're not high emitters, what it will take, and the analysis shows that if companies and all of our suppliers go to renewable electricity we should be able to hit that 50% reduction by 2030. It does not mean at all it's the only thing we should do, but it allows us to get comfortable that we can start building very tangible plans towards achieving the targets, and build out processes for getting there.

Veronique Menou (03:06):

Increasingly, we are hearing our stakeholders ask us to, and ask companies in general, not only to have long-term goals but also to have milestones along the way that are consistent with that long-term goal.

Adam Bass (03:21):

That's our next guest.

Veronique Menou (03:23):

I'm Veronique Menou and I'm based in the MSCI Paris office, and I'm the head of corporate responsibility.

Adam Bass (03:30):

Who built on that idea during our conversation?

Veronique Menou (03:33):

In our own model, at MSCI, we give more credit to companies with interim targets. And so as a result, from a corporate standpoint, we have also define a net zero goal before 2040, and we have an interim target that we are in the process updating to align it with a 1.5 degree pathway. And we recently commuted to submit not only this near term target once it's updated, but also our long-term commitment for verification by the Science Based Target initiative.

Veronique Menou (04:13):

This initiative is emerging as a standout in the industry, so having it certified will help in terms of the credibility of our target. SO, then when we ask our suppliers to have similar commitment as ours, then we could also point them to the Science Based Target initiative and have them have their own target certified.

Adam Bass (04:39):

The Science Based Targets initiative, or SBTI, you knew there'd be an acronym, right? The goal of SBTI is to create a framework that takes climate commitments, or carbon reduction targets, which are created with different levels of scope, and make them consistent. And more importantly for investors, make them comparable. But, as I mentioned at the top of the program, the question is, what comes after commitment? How do you measure progress?

Diana Tidd (05:09):

There's no specific playbook of action for how to get to net zero, so it's new for many companies. First they have to think about, even, how is it relevant for them, so there are some leading providers in ESG and climate space that work in these areas, but there is no single framework today for how to get to net zero or exactly how to achieve your carbon targets. So, that makes it more complex for companies and a learning process, really, for everybody.

Diana Tidd (05:41):

It also makes comparing companies to each other, in these areas, more complex. So, as you're thinking about implementing your approach you want to look at what other companies are doing, but that's not simple. It's complex but there are some tools out there. It's actually an area where MSCI comes in. We provide tools, metrics and ratings to help companies understand if they are on the 1.5 degree path, and to compare themselves to other companies.

Adam Bass (06:09):

And it's not just companies, of course, investors are facing pressure to work toward net zero portfolios. For that perspective, we turn to our third guest.

Jorge Mina (06:20):

Hi, I'm Jorge Mina. I run the analytics product line at MSCI, been with the company for about 24 years. Achieving net zero is now a common goal for companies as well for investors, so there's clearly a lot of similarities. They both need to set their goals, they need to make sure that they can measure and report where they are, so their starting point. From there they can make decisions in terms of how to reduce emissions, whether it is in the company or in the portfolio, and then measure and report progress towards the goals that they set.

Jorge Mina (06:54):

So, all that is very similar but there's also some differences, investors need to do these across their entire portfolios. And they not only invest in companies, whether it's through equities or bonds, but they also invest in sovereign bonds and municipals, and mortgages, and real assets, and a lot of things tat are not companies. So, they have a broader problem, so to speak, and they need to take a holistic view, and then decide how to achieve those goals. And they have a number of tools to do that. SO, one of them, for example, is engaging, engaging with the companies, so there's also a lot of interaction between the investors and the companies.

Jorge Mina (07:32):

Investors want to make sure that those companies have plans to reduce their emissions because that in turn will be an important tool for investors to get to net zero in their portfolios as well. They can take more drastic measures< so these investors can also divest for carbon intensive industries, or from specific companies in an industry that don't have a solid plan to reduce their emissions.

Jorge Mina (07:57):

And then on the positive side, there's ways to capture opportunities, they can be investment in green technologies, and opportunities for those are increasing over time as more and more people put capital toward green assets. And they also benefits financially from companies with high exposure to climate risk by potentially shorting those assets, and how those are treated is important, and those are reported is important because obviously if investors think that, whether you're long or short and asset, the growth exposure is what matters, then you're moving a tool available to them to manage climate.

Adam Bass (08:42):

There are other important differences for investors to consider. For example...

Jorge Mina (08:47):

They're increasingly looking to manage, or they're being pushed to manage what is called double materiality. So, what climate change does for companies on the one hand, and also what are those companies ding to the environment? But as they do that they need think about how they're going to meet their fiduciary responsibility, so asset managers need to look after the best interest of their clients, that's a promise that they've made. And asset owners need to look at the best interest of their beneficiaries, and so both asset managers and asset owners need to develop these net zero strategies consistent with their fiduciary obligations, and also align all the stakeholders and their expectations. So, not just their clients or their beneficiaries but also regulators, and even the general public. So, that may require amendments to the investment guidelines that they have.

Jorge Mina (09:44):

So, said a different way, if you think about it, delivering the best returns for investors is not the same thing, or not always consistent with achieving net zero. It all meets in the long run, but in the short run aggressive denationalizational portfolio can potentially lead to some business risk by, for example, missing out on short term price increases or narrowing the investment universe available to investors.

Adam Bass (10:16):

So, where are investors on this journey? I asked Jorge for his impressions based on the many conversations that he has with clients.

Jorge Mina (10:25):

We are still in the very early stages of understanding the financial risk that is posed by climate change. We know that it's high but we need t be more precise in terms of how we measure it and understand it, and implimentation on the net zero investing is very complex, it requires the adoption of new data, of new systems, we need to know emissions at a [inaudible 00:10:49], industry level, at the portfolio level, at the entire enterprise level. And the requires the incorporation of this data in various areas of a company. So, for example, portfolio managers need to incorporate it, the marketing function, compliance function, investor relations, and so and so forth. So, it's clearly a complex and challenging topic, and we're still in the early days of really even gathering all the data that's necessary to get a full understanding of this.

Jorge Mina (11:21):

So, the approach that everyone's taking is, "Let's get to full coverage of all the assets in the portfolio and then improve from there." So, starting with carbon footprinting, which is to basically measuring the finance emissions for all of the assets and all the portfolios across our enterprise. And then, over time, improving the quality and the sophistication of the data. So, this is how things get better and we've actually seen this before in other disciplines that we know very well, for example, in risk management.

Jorge Mina (11:52):

In the early '90s JP Morgan's CEO, Dennis Weatherstone, asked for a report at 4:15 pm, so it was called the 415 report, that combined all the risks of the firm on a single page. Now, the report use very simple [inaudible 00:12:08] measures that were then vastly, vastly improved over the years, but at the time that 415 report was very important because it provided a timely picture of the risks of the entire bank. And so, the CEO that a huge improvement over where they were.

Jorge Mina (12:26):

And this is exactly where we need to start in climate, I think it was Cane who said, "It's better to be approximately right than exactly wrong." And that's what we need to do first, and then from there get to more sophistication and improve the quality and the details around it.

Diana Tidd (12:46):

At times I think of it like running a business. We often, in business, test new hypothesis of how we might be able to drive growth in a new area of the business and we incubate ideas, we start to gather information on them, and metrics, and then we fine tune those. And so, I think the same applies in this area. There's definitely plenty of testing, there's a lot of estimating, and to me that's an important starting point because you have to start somewhere.

Diana Tidd (13:15):

So, you can build it up over time to having more complex areas, for example, looking at your carbon footprint and having it be precise instead of modeled. But in general, simply having an estimate often means you're starting your path towards decarbonization, or in any of these areas of corporate responsibility, it's creating a baseline measurement from which you can measure your progress. So, it may not be perfect but I think perfection may hinder progress, if we seek that upfront. And, really, it's okay, I think, in these areas that they're models and they're estimates, they get us started and they teach us what we need to think about to actually perfect them and be on the right path over time.

Adam Bass (14:01):

So, if you have to start somewhere, where do you start? For many companies their supply chain makes up the bulk of their carbon emissions. These are the scope three emissions we've spoken about before. If we use MSCI as an example that's certainly the case.

Veronique Menou (14:18):

As a service provider we have an absolute compared to some of the bigger meeting sectors, we have low emissions. I was looking at the biggest emitter in MSCI [inaudible 00:14:32], and that company

emits more than two billion tons of CO2 while we emit 39,000. So, obviously our risks exists but it's fairly low compared to other companies in high emitting sectors. At MSCI we have four major sources of emission. The first one, which is the biggest, is the emissions coming from purchased goods and services. SO, the emissions from our own suppliers. And they account for about 75% of our total footprint.

Veronique Menou (15:09):

The second one is the electricity, so the emission associated with the electricity that we use in our offices. And that accounts for about 10%. And then we have business travel and employee commute, that account for abour 4% respectively. So, overall our scope three emissions account for more than 90% of our total emission.

Veronique Menou (15:36):

So, now, how do we address that? So, what we've done is we've put together a sustainable supplier management program and we have a dedicated team working within this program. They want to understand our suppliers and they're commitment, not only on the climate front but also their DNI commitment as well as their corporate responsibility practices. Then the second thing they're doing is identify the suppliers who are critical to us from a business perspective.

Veronique Menou (16:13):

And then, third, they are engaging with those key suppliers to educate them and have them align with similar commitment as ours, so we are educating, encouraging our suppliers to define climate commitment that are as ambitious as ours. So, just to give you an idea, as of today more than 40% of our suppliers have climate commitment, so this is obviously a very good percentage but we are working to increase that percentage in order to meet our net zero goal.

Adam Bass (16:51):

But what if some of the companies in your supply chain or in you portfolio, for that matter, are private companies? Doesn't that make it more difficult to get a true sense of their carbon emission and, by extension, your own?

Jorge Mina (17:06):

The pressure has been bigger on public companies, for sure, so the quality of the data and the availability of the data is much better but we're seeing also a big push to start implementing very similar reporting standard for private companies. So, in many cases that's coming through the private equity investors that own those companies that are now being pushed to provide that transparency to

their investors, and so it's going to take a little bit longer for private companies but over time I'm convinced that we're going to get to similar standards across the board.

Diana Tidd (17:47):

Private companies, inherently, don't disclose as much because of the structures they're in, being private and not public, and not having the same requirements. But the public company requirements of the US SCC pending rule, for example, is for public companies or companies issuing public debt. When you look at private companies we do see that around the world they tend to be at an earlier stage, different levels in different regions but certainly at an earlier stage, many of them, of their thinking about these areas. And so, the pending rules can help them understand, themselves, what might be important to them, but they actually also will start to see more and more focus as the client demand for those investing in, for example, private equity. The investors in that want to see the same level of information as they see on public companies, because they're used to seeing it and they think it's important.

Diana Tidd (18:45):

Another area for pressure on private companies will be supply chain pressure, where companies like MSCI and so many others across the world are starting to engage way more actively with their supplier to say, "You're part of our carbon footprint, how are you thinking about carbon commitments and where are you on that path?" And so, for us at MSCI and in many companies, that means starting to ask the questions of these private companies for suppliers, but also for MSCI we think about, "How can we educate them to help bring them along the path?"

Diana Tidd (19:21):

Over time we've seen a progression, we see it in proxy guidelines for public companies, where those guidelines about areas of corporate responsibility have become more and more specific over time. So, that's for public companies but you can imagine for privates, their various stakeholders also, and it's starts broad in understanding that they need to be educated. But over time, as we all need to achieve, for example, our carbon targets, that pressure could get significantly stronger for them.

Adam Bass (19:54):

So, supply chain issues, clearly the largest slice, but what about the non-supplier emissions that Vero mentioned? What about, say, energy use?

Veronique Menou (20:05):

We have several levers at our disposal to reduce the scope to emissions. The first one is that we will continue to increase efficiency in the office and, for example, continue select green certified building.

The other lever is around reducing occupancy and, similarly we have a future of work program and we are promoting flexible work environment. So, that's already in the works.

Veronique Menou (20:39):

And then the third lever, for us, is to increase renewables, but it's not necessarily available in every office that we have, and we're also leasing office space. So, what we do is we engage with landlords but we're also exploring what we call energy attribute certificates, EACs. And so, just to name a couple of examples of EACs in the US, for example, they're called recs or in the EU we call them guarantee of origin. And what they are is they are certificates that prove that one megawatt hour of electricity was generated from renewable sources. So, by purchasing them a company can then claim that their electricity is green, and as a result can also reduce the scope to emissions. So, that's a lever that we are exploring and we could potentially rely on them to reduce our scope to emissions.

Adam Bass (21:41):

Now, when you talk about EACs and that description I can hear people linking them with carbon offsets, which are met with some skepticism in the ESG climate community. Can you address that? Are they the same as offsets or, if not, how are they different?

Veronique Menou (22:01):

So, carbon offsets represent one ton of CO2 that is either removed or avoided, as opposed to energy attribute certificates we're talking about the one we get with hour of electricity. But you're right that they're often considered similarly, but there are differences because it is true that for carbon offsets this is not a very transparent market, it is a complex market and they've been different controversies. So, it's important to look for additionality and high quality verification, as well as permanent for carbon offset.

Veronique Menou (22:47):

For EACs it's a bit different because it's very local and it's more regulated than the carbon offset market. So, for example, if you look at the science based target methodology EACs are allowed while carbon offsets are not. That said, it's also important to mention that if you want to be authentic the company should also look at other levers, but definitely EACs are also a credible tour that is recognized by [inaudible 00:23:25], an external verifier, as a relevant mechanism to use to meet carbon targets.

Adam Bass (23:33):

I mentioned at the top of this episode that we were going to get as specific and concrete as possible. And so, along with choosing whether to use EACs or addressing issues with a suppliers net zero

approach, if getting to net zero is truly a goal you're going to need to build the infrastructure within your company and you're going to need to get buy-in.

Diana Tidd (23:57):

If you think about corporate responsibility, one aspect if it is transparency. And so, that's a very important aspect because your stakeholders can't really know where you are unless you're sharing information with them. So, corporate responsibility data is a category that is complex, so corporate responsibility data may come from your cyber security teams at the firm, so IT. It may come from your procurement teams who are working with the supply chain to report on metrics about their climate and carbon target progress, or their diversity, and it may come from HR. And basically the data can come from all over the firm, but it's being, in many cases, publicly disclosed.

Diana Tidd (24:43):

And so, companies are now really starting to focus on, "How do we ensure that the proper processes, controls, even potentially assurances from third parties are in place to ensure that this data has the same level of integrity and accuracy as any other publicly reported data, and also their areas about the governance of corporate responsibility." More and more shareholders are wanting to see, and other stakeholders as well, how companies are thinking about the oversight of corporate responsibility in climate.

Diana Tidd (25:20):

So, where does climate risk sit? In terms of board committees there's physical risk, is that audit? There's transition risk, is that governance or is that across the full board? There's compensation metrics, so are leaders being paid and evaluated on whether they're achieving climate commitment goals, for example, so that's talent and comp committees. So, really mapping out across the organization where the owners are, where the oversight is happening, and then also making sure that the information reported to those groups is the relevant information for them to be able to give good guidance and oversight.

Diana Tidd (26:02):

As a chief responsibility officer, I want to give decision-making tools to the leadership of the firm so that they can participate and support achieving our carbon targets. I want to share the targets with others and not have it siloed off in corporate responsibility. So, I don't want to tell them what to do and have to come to them in a few years and say, "Sorry, this supplier has not set a carbon target, and so we need to change suppliers." Instead, I want to give them the tools and processes to allow them to be part of good decision-making about the firm's strategy and the carbon commitment.

Diana Tidd (26:38):

So, carbon pricing, to me, is a good example of that where you can essentially integrate carbon metrics right into your budgeting process. And so, the stakeholders and decision makers who are acting on your budget can actually see the carbon impact of their investments and their decision making fr the operating plans for the coming year. So, carbon pricing is newer in a lot of areas, but to me it's a really interesting way and a tool to help integrate climate thinking across your firm so that all the key stakeholders are part of this important part of the firm strategy, and it doesn't sit siloed in a particular division.

Adam Bass (27:20):

And how do you go about, I guess in both directions, in terms of selling the idea, for lack of a better term. I'm wondering about selling it up to management, but also to these managers who will need to put these methods into place, whether it's carbon budgeting or other approaches.

Diana Tidd (27:41):

It's a great question, and I think an important part across all the industries. And I imagine, for corporate responsibility is really developing persuasion skills, because corporate responsibility goes across an entire company. So, you're acting across all these different functions. A recent example is, as we were looking at our carbon targets and how we're going to achieve them, we talked to a bunch of the senior leaders in our corporate responsibility policy committee about actions we could take to achieve our carbon target. And we were really drilling in to, "How does this impact our office footprint, our suppliers, and, specifically, what are the levers we could take to achieve our goals?"

Diana Tidd (28:26):

And I was excited when one of the leaders came back and said, before we put our proposal to them on carbon pricing, to say, "This needs to be integrated into our budgeting, this has to be part of our process, people need to understand the impact on the investments we're making." This is an area where you have to think strategically about how to provide the right type of information and help stakeholders digest that information, and conclude along with you how many actions you need to take. Trying to force carbon pricing across a firm, or trying to force action with suppliers, I think, builds up resistance and you really don't get to true integration.

Adam Bass (29:08):

We've spent a lot of our time today talking about difficulties, difficulties when it comes to data, measurement, selecting the right leverage to pull, as Vero put it. And difficulties managing the pressures from many different stakeholders. But there's another side to the story, working toward net zero can have some positive effects outside of continued life as we know it. Jorge spoke earlier about potential investment opportunities, there are opportunities that exist for companies as well.

Diana Tidd (29:43):

I had my nieces, I was texting them recently that Sephora was having a sale on makeup that was clean, non-toxic and sustainable. So, that's the kind I buy so I sent them a not, like, "Oh, they're having a big sale on this, in case you guys are interested. I know you care about that." And the responses I got really made me laugh because they made me step back. This generation, at least [inaudible 00:30:06] with my nieces, they're looking for companies who don't have a line of products or just distributing products that are non-toxic and sustainable. They're looking for new companies, a lot of the companies they shop in are newer companies that have divers leaders, that have net zero targets and have fully integrated into the value system of the company, sustainability and having non-toxic products. So, it was just interesting to see how much that is embedded in the generations that are coming, and are the future workforce for so many of our companies.

Veronique Menou (30:43):

There was an [inaudible 00:30:44] the other day saying that 75% of the workforce will be millennial in 2025, and so that's also one of the reason why we have strong corporate responsibility initiatives, DNI initiatives. And we heard from our employees who really like the fact that we are a climate leader and we are walking the talk, and there increasingly we see also interest from our employees in participating in our climate action networks. Their role is about education employees around climate and environmental issues, so right now it's difficult to really measure whether it drives engagement, or it drives motivation, but we do believe that it will definitely attract and retain talent being a leader in climate and corporate responsibility more broadly.

Adam Bass (31:46):

And there's more.

Diana Tidd (31:48):

Companies need to consider the risks, and that's part of their job and part of their key strategy and their operating processes, but also there's potential tremendous growth opportunities that corporate responsibility and climate action can drive. If we prepare for climate change companies will have better management of potential costs because they'll have more warning time of what's to come, and so they'll be able to, presumably, manage costs better but also, as I said, they'll be able to see these long-term growth opportunities and action them in a fast changing world.

Diana Tidd (32:25):

In terms of capital flows, we see money pouring in to climate and ESG focused funds. So, this relates to access to capital for companies, whether they're public or private companies. In terms of lower cost of capital for companies, we think about companies issuing debt and what considerations banks are making with regard to how they're thinking about the companies or their own loan book and the carbon

footprint of that, and so their starting to consider areas related to corporate responsibility and climate. So, we really think it's key to driving long-term growth.

Adam Bass (33:06):

That's all for this week. A big thank you from Joe and me to Diana, Vero and Jorge. And to all of you for listening. Next up on Perspectives, the explosion of data has traded nearly endless possibilities for investors, we'll explore ways to harness that power. Until the, I'm your host, Adam Bass, and this is MSCI Perspectives. Stay safe, everyone.

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